No. 88-1690

Supreme Court, U.S.
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1988

GREATER BUFFALO PRESS, INC., individually, and as payee and holder; and on behalf of each other similarly situated payee and holder on Appendix A; of returned or non-paid checks or cash items drawn by NEISNER BROTHERS, INC., on CHASE LINCOLN FIRST BANK, N.A., (formerly THE LINCOLN FIRST BANK);

Petitioner,

VS.

FEDERAL RESERVE BANK OF NEW YORK, and the Buffalo, NY Branch thereof; JOHN T. KEAN, individually, and as an Officer and Manager thereof;

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

RESPONDENTS' BRIEF IN OPPOSITION

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QUESTION PRESENTED

Whether the court of appeals properly affirmed the judgment of the district court, which granted the summary judgment motion of the respondents and dismissed this suit brought by the petitioner, who alleged that the respondents failed to exercise ordinary care in the handling of checks drawn by a bankrupt?

STATEMENT BY CORPORATE RESPONDENT

The respondent, Federal Reserve Bank of New York, is a corporation chartered under the laws of the United States pursuant to the Federal Reserve Act. 12 U.S.C. § 226 *et seq.* Respondent has no parent company nor does it have any partially-owned subsidiaries or affiliates. Although stock of the respondent is owned by member commercial banks within the Second Federal Reserve District, none of the shareholders control the respondent. This statement is made pursuant to Supreme Court Rule 28.1.

TABLE OF CONTENTS

	PAGE
QUESTION PRESENTED	i
STATEMENT BY CORPORATE RESPONDENT	ii
JURISDICTION	2
STATEMENT OF THE CASE	2
SUMMARY OF ARGUMENT	4
REASONS WHY THE PETITION SHOULD BE DENIED	4
1. The Decision Below is Not Based Upon an Important Question of Federal Law	4
2. There is no Dispute Among the Courts of Appeals Concerning the Effect of the Sender Rule	5
3. The Petitioner's Invitation to Deliver an Advisory Opinion Regarding a Repealed Regulation Should be Declined	6
4. There are Alternative State Law Grounds for the Decision	7
5. Petitioner's Claim that the Decision Below Works an Injustice of Constitutional Proportion is Meritless	8
6. The Decision Below Will Affect No Other Litigants	9
CONCLUSION	10

TABLE OF AUTHORITIES

Cases PAGE

Appliance Buyers Credit Corp. v. Prospect Nat'l Bank of Peoria, 505 F. Supp. 163 (C.D. Ill. 1981), *aff'd*, 708 F.2d 290 (7th Cir. 1983) 5, 6

Childs v. Federal Reserve Bank of Dallas, 719 F.2d 812 (5th Cir. 1983), *rehearing denied*, 724 F.2d 127 (5th Cir. 1984) 5

Colonial Cadillac, Inc. v. Shawmut Merchants Bank, N.A., 488 F. Supp. 283 (D. Mass. 1980) 5, 6

Continental Illinois Nat'l Bank and Trust Co. v. Chicago R. I. & P. Ry. Co., 294 U.S. 648 (1935) 9

First Nat'l Bank of Gatlinburg v. Republicbank Dallas, N.A., 676 F. Supp. 128 (N.D. Texas 1987) 5

Hanover Nat'l Bank v. Moyses, 186 U.S. 181 (1902) ... 9

Northbrook Trust and Sav. Bank v. Palos Bank and Trust Co., 505 F. Supp. 1002 (N.D. Ill. 1981) 5

Port City State Bank v. American Nat'l Bank, 486 F.2d 196 (10th Cir. 1973) 8

Washington Petroleum & Supply Co. v. Girard Bank, 629 F. Supp. 1224 (M.D. Pa. 1983) 5

Statutes

12 C.F.R. § 210.2(e) (1977) 3

12 C.F.R. § 210.6 (1977) 3

12 C.F.R. § 210.6(a) (1977) 4

12 C.F.R. § 210.14 (1988) 8

12 U.S.C. § 226 ii

PAGE

12 U.S.C. § 632 2

28 U.S.C. § 1254(1) 2

28 U.S.C. § 1331 2

28 U.S.C. § 2106 2

28 U.S.C. § 2111 2

N.Y.U.C.C. § 4-103(3) (McKinney 1964) 5

N.Y.U.C.C. § 4-103(5) (McKinney 1964) 3, 7, 8

N.Y.U.C.C. § 4-108 (McKinney 1964)..... 7, 8

N.Y.U.C.C. § 4-201 (McKinney 1964) 3, 4, 5

N.Y.U.C.C. § 4-202 (McKinney 1964) 3, 4, 5

Other Authorities

51 Fed. Reg. 21740 (June 16, 1986) 9

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RESPONDENTS' BRIEF IN OPPOSITION

The respondents, Federal Reserve Bank of New York and John T. Kean,[1] respectfully request that this Court deny the petition for writ of certiorari, seeking review of the Second Circuit's opinion in this case. That opinion (Pet. App. 1a-21a) is

1 Because Mr. Keane is an officer of the Federal Reserve Bank of New York who acted within the scope of his authority, his interest in this action is coincident with the interest of his employer, and this brief will refer to Mr. Keane and the Federal Reserve Bank of New York collectively as "respondent."

reported at 866 F.2d 38 (2d Cir. 1989). The opinion of the district court (Pet. App. 22a-35a) is not reported.

JURISDICTION

The judgment of the court of appeals was entered on January 18, 1989. The petition for a writ of certiorari was filed on April 18, 1989. The jurisdiction of this Court is invoked under 28 U.S.C. §§ 1254(1), 2106, and 2111. Federal subject matter jurisdiction in the lower courts was based on 12 U.S.C. § 632 and 28 U.S.C. § 1331.

STATEMENT OF THE CASE

1. Respondent is a part of the Federal Reserve System, the nation's central bank. One of the banking functions performed by the respondent, the collection of checks, is the function involved in this action.

2. Petitioner, Greater Buffalo Press, Inc., brought this action in the United States District Court for the Western District of New York on behalf of itself and 59 other parties, who are said to be similarly situated. Petitioner contended that respondent failed to exercise ordinary care in presenting checks to the bank on which they were drawn. Petitioner was a payee on two of these checks. The checks were all drawn by Neisner Brothers, Inc., a bankrupt retail department store, and were intended to pay the petitioner and the 59 other parties for goods and services. Petitioner was a trade creditor of the bankrupt.

3. Petitioner contended that, if respondent had exercised ordinary care in presenting the bankrupt's checks, those checks would have been presented by the respondent to the bank on which they were drawn before the bankruptcy petition was filed. If that happened, the petitioner further contended, then the checks would have been fully paid.

4. After nine years of pre-trial proceedings, including extensive discovery, the respondent filed a motion to dismiss the action, or alternatively, for summary judgment. The district

court ordered that the motion "be granted in all respects." Pet. App. 32a. Accordingly, judgment was granted to the respondent dismissing the petitioner's complaint. Pet. App. 32a.

The district court determined that, during the time material to this action, a Federal Reserve Bank acted as agent of the "sender" only (12 C.F.R. § 210.6 [1977]) in handling a check, and that the statutory duty to exercise ordinary care in the presentment of checks was a duty owed by the collection "agent" to its principal only. N.Y.U.C.C. §§ 4-201, 4-202 (McKinney 1964). Because the then-operative provision of Regulation J of the Board of Governors of the Federal Reserve System provided that Reserve Banks were the collection agents of the sender only, and because the payee of a check was excluded from the definition of "sender" (12 C.F.R. § 210.2(e) (1977)) (Pet. App. 43a), the respondent owed no duty to the petitioner because petitioner was not respondent's principal. Alternatively, the district court found that, with respect to 63 of the 75 checks involved in the action, there were no "actionable claims with respect to these checks. U.C.C. § 4-103(5) (McKinney 1964)." Pet. App. 34a. As for the remaining 12 checks, the district court believed that "[d]eterminations . . . could not have been made on the papers." Pet. App. 34a n.10.

5. The court of appeals affirmed the judgment of the district court, holding that the respondent did not owe a duty to petitioner under the Uniform Commercial Code (hereafter "UCC" or "Code"), because of Regulation J's "sender" rule. Pet. App. 16a. The court reasoned that:

> The application of Regulation J to this case is straightforward. The [petitioner's] cause of action against [the respondent] is based entirely on the theory that [it] breached duties required of it as an agent of the [petitioner] in the check collection process. Regulation J unambiguously 'severs the agency relationship' between [the respondent] and the 'non-sender' [petitioner]. [Citation omitted.] Because Regulation J requires that [respondent] not be considered an agent of the [petitioner], [respon-

> dent] cannot be found to have owed the [petitioner] any duty . . . .

Pet. App. 16a.

The decision below acknowledged the legitimate policy rationale for the sender rule, accepting that the rule assisted the Reserve Banks in offering a "free" check collection service. The rule "effectively limited the Reserve Bank's duty to exercise ordinary care to only those institutions who were receiving the gratuitous service, thereby reducing losses as well as the overall cost of the service." Pet. App. 19a.

SUMMARY OF ARGUMENT

The court of appeals properly affirmed the judgment of the district court, which was supported by an opinion that: (a) was based upon case law that is uniform among the courts of appeals; (b) contained alternative reasoning premised upon State law grounds; and (c) interpreted a provision of Regulation J that was repealed in 1986. Consequently, the petition should be denied.

REASONS WHY THE PETITION SHOULD BE DENIED

1. The Decision Below is Not Based Upon an Important Question of Federal Law.

Petitioner incorrectly believes that this action was resolved on the basis of the sovereign's immunity (Pet. 9), but that clearly is not the case. Instead, both the district court and the court of appeals held that the respondent owed no agency duty to the petitioner to exercise ordinary care in handling checks because petitioner was not the respondent's principal. The basis for this holding was State law, namely N.Y.U.C.C. §§ 4-201, 4-202 (McKinney 1964), as supplemented or modified by the "sender" rule of Regulation J. 12 C.F.R. § 210.6(a) (1977).

As the Second Circuit stated, the petitioner "cannot recover against [the respondent] by simply criticizing its operations [and

can sustain its action] only by reliance on the provisions of New York's Uniform Commercial Code that deal specifically with the duties of banks in collecting and processing checks. *See* N.Y.U.C.C. §§ 4-201, 4-202 (McKinney 1964)." Pet. App. 11a.

Because the decision below rests most fundamentally upon an interpretation of New York's Uniform Commercial Code, there is no substantial Federal question at issue. To be sure, Regulation J was an important ingredient in the interpretation, but this regulation should be viewed as an agreement supplementing State law (N.Y.U.C.C. § 4-103(3) (McKinney 1964)) instead of Federal law that overrides it. Pet. App. 16a-17a. When properly viewed, the sender rule has the force of an "agreement" varying State law and there is no Federal law question to be considered by this Court.

Consequently, there is no significant issue of Federal law in this case.

2. There is no Dispute Among the Courts of Appeals Concerning the Effect of the Sender Rule.

The Federal courts have uniformly decided that the duty of a Federal Reserve Bank to exercise ordinary care in collecting checks, during the time when the "sender" rule was extant, was owed only to so-called "senders" of checks. Therefore, the decision in this case that the respondent did not owe any duty of care to the petitioner (who was not a sender) is completely in accord with the rulings of other Federal courts. *See Childs v. Federal Reserve Bank of Dallas*, 719 F.2d 812 (5th Cir. 1983), *rehearing denied*, 724 F.2d 127 (5th Cir. 1984); *First Nat'l Bank of Gatlinburg v. Republicbank Dallas, N.A.*, 676 F. Supp. 128 (N.D. Texas 1987); *Washington Petroleum & Supply Co. v. Girard Bank*, 629 F. Supp. 1224 (M.D. Pa. 1983); *Northbrook Trust and Sav. Bank v. Palos Bank and Trust Co.*, 505 F. Supp. 1002 (N.D. Ill. 1981); *Appliance Buyers Credit Corp. v. Prospect Nat'l Bank of Peoria*, 505 F. Supp. 163 (C.D. Ill. 1981), *aff'd*, 708 F.2d 290 (7th Cir. 1983); *Colonial Cadillac, Inc. v. Shawmut Merchants Bank, N.A.*, 488 F. Supp. 283 (D. Mass. 1980).

Although it may be true that district courts[2] have differed in their analysis of the inter-relationship between the sender rule and the UCC (*Compare Appliance Buyers Credit Corp. v. Prospect Nat'l Bank of Peoria*, 505 F. Supp. 163, 164 (C.D. Ill. 1981), *aff'd*, 708 F.2d 290 (7th Cir. 1983) (viewing the sender rule as an agreement varying the UCC) *with Colonial Cadillac, Inc. v. Shawmut Merchants Bank, N.A.*, 488 F. Supp. 283, 286 (D. Mass. 1980) (viewing the sender rule as preempting the UCC)), these courts have had no difficulty in applying the rule to reach a uniform conclusion: Regulation J limited the duty that Reserve Banks owe to exercise ordinary care in handling checks to the sender only. Pet. App. 15a.

Thus, this represents a simple commercial case decided in accordance with well-settled case law. It has nothing whatsoever to do with the immunity of the sovereign, the money supply, or the fanciful cover-up referenced in the Petition.

3. The Petitioner's Invitation to Deliver an Advisory Opinion Regarding a Repealed Regulation Should be Declined.

The petitioner complains that "the Second Circuit never made [it] clear" whether Regulation J is an agreement varying the UCC or Federal law overriding it (Pet. 13), and urges the Supreme Court to "resolve the nature and extent" of this issue. Pet. 13. This argument is first, incorrect, and second, immaterial.

First, the Second Circuit found that the sender rule was an agreement varying the Code. The statement that "this case reveals no basic inconsistency between Regulation J and the New York Uniform Commercial Code" is hostile to any preemption analysis (Pet. App. 16a), and recognizes that the now-repealed sender rule is an agreement varying the Code.

Second, the subsidiary question whether the "sender" rule preempts the UCC or "varies [it] by agreement" need not be answered, because it is unnecessary to the resolution of the litigation. The only necessary considerations are whether the

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2 The Fifth and Second Circuits are in perfect harmony.

sender rule governs the case at hand, and if it does, what is the outcome. The answer to both questions is clear under well-settled law: the sender rule applies, and it precludes the petitioner from recovering against the respondent. Further, the repeal of the sender rule makes the petitioner's request for an opinion addressing the rule's doctrinal foundation a request that the Court engage in an academic exercise.

4. There are Alternative State Law Grounds for the Decision.

Even if respondent had a duty to exercise ordinary care in handling petitioner's checks and owed that duty to the petitioner, a proposition that Federal courts have uniformly rejected in cases like this, there are alternative State law grounds for the decision below under N.Y.U.C.C. §§ 4-103(5) and 4-108 (McKinney 1964).

The district court, for example, found an alternative basis for summary judgment with respect to 63 of the 75 checks involved—the court found that the payees had no actionable damages on these checks because they would have been uncollectible even without the respondent's processing delay. Pet. App. 34a at note 10. The basis for the district court's determination was N.Y.U.C.C. § 4-103(5), which authorizes a direct damage recovery only if the respondent's alleged failure to exercise ordinary care was the cause of the petitioner's inability to recover the full amount of a check. The district court thought there were material facts that precluded extension of this alternative rationale for summary judgment to claims regarding the remaining 12 checks.

In the court of appeals, respondent demonstrated, in alternative support of the judgment of the district court, that the balances which would have funded the payment of the 12 remaining checks (a fact essential to a recovery because of Section 4-103(5)) were generated by the bankrupt's deposit of so-called depositary transfer checks ("DTCs"). Because the funding DTCs were caught in the same processing delay as the checks of the petitioner, the respondent's processing delay gave an appearance of sufficiency to the balances which would have

funded payment of petitioner's checks. Thus, the balances which the petitioner believed were sufficient to pay its checks were not, in fact, "good" balances. "But for" the respondent's processing delay, the drawer of the 12 checks would have filed for bankruptcy sooner.

Thus, N.Y.U.C.C. § 4-103(5) provides an alternative State law basis for the decision below, and rests entirely upon the unique facts of the case.

Still another alternative State law basis for the decision below is N.Y.U.C.C. § 4-108, which excuses delays resulting from *force majeure* conditions like computer breakdowns. *Accord*, 12 C.F.R. § 210.14 (1988). *See Port City State Bank v. American National Bank*, 486 F.2d 196 (10th Cir. 1973) (interpreting 12 C.F.R. § 210.14). The delay of the respondent in this matter resulted from a concatenation of two phenomena, an abrupt increase in check processing volume and a computer breakdown. Pet. App. 27a-29a. This is the type of condition that is excused by Section 4-108, and this particular Code provision affords respondent with yet another complete defense that applies to all of the 75 checks involved in this action.

5. Petitioner's Claim that the Decision Below Works an Injustice of Constitutional Proportion is Meritless.

The petitioner's claim that the payees of the bankrupt's checks "were left without an effective remedy" (Pet. 15) is simply untrue. The payees of the checks were able to claim against the bankrupt drawer of the checks just like any other creditors of a bankrupt. Furthermore, the distribution approved by the Bankruptcy Court that handled the drawer's bankruptcy was between 45 and 65 cents on every dollar claimed. In view of this substantial distribution, the petitioner's assertion that the "Second Circuit's decision . . . leave[s] the holders remediless . . ." is nothing more than an advocate's puffery.

The petitioner's real grievance is with the court of appeals' refusal to place the respondent in the position of an unsecured creditor of the bankrupt drawer, and to make the respondent accountable for the petitioner's poor credit judgment. In effect,

that is the relief which the petitioner has sought throughout this action.

The Second Circuit's failure to grant this relief is hardly "unfair," because it was the petitioner's credit judgment that was "bad." Further, the decision below surely did not leave the petitioner "remediless." It left the petitioner free to pursue a claim in bankruptcy, which is the proper procedure for anyone who misjudges a bankrupt's creditworthiness. Of course, the Bankruptcy Law's limitation of the monetary value of a creditor's right is not "unconstitutional" (*see, e.g., Continental Illinois Nat'l Bank and Trust Co. v. Chicago R. I. & P. Ry. Co.*, 294 U.S. 648, 674 (1935); *Hanover Nat'l Bank v. Moyses*, 186 U.S. 181, 187-189 (1902)), and neither is the decision below.

6. The Decision Below Will Affect No Other Litigants.

The Board of Governors of the Federal Reserve System repealed the "sender rule" from Regulation J in June of 1986. 51 Fed. Reg. 21740 (June 16, 1986). Consequently, the result in this case will not be repeated because the rule that determined the outcome no longer exists.

Further, respondent is not aware of any pending litigation that would be affected by the repealed rule. Therefore, the disposition of this action affects only the parties to the action, and the decision below has little, if any, precedential effect.

CONCLUSION

For these reasons, the petition for a writ of certiorari should be denied.

Dated: New York, New York
May 17, 1989

Respectfully submitted,

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